

# Macquarie Master Enhanced Fixed Interest Fund

Quarterly report – 31 March 2022

## Investment objective

Aims to outperform the Bloomberg AusBond Composite 0+ Yr Index over the medium term (before fees). It aims to provide regular income and a moderate level of growth.

## Key information

### Fund details

APIR code	MAQ0180AU
Inception date	17 May 2000
Fund size	\$13.0m
Distribution frequency	Quarterly
Management fee*	0.290% pa
Minimum investment (Direct)	\$100,000
Unit prices and spreads	<a href="https://macquarie.com.au/unit_prices">macquarie.com.au/unit_prices</a>

\*Read the Product Disclosure Statement for more details on fees and costs.

## Fund performance to 31 March 2022

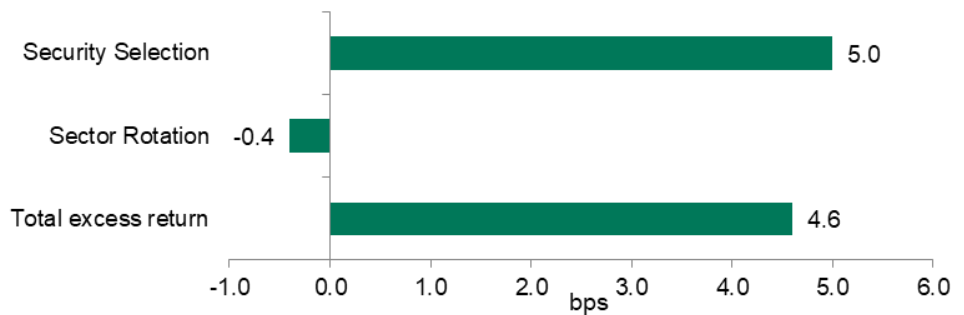
	Total Fund return (gross)	Benchmark return	Total excess return (gross)	Total Fund return (net)*
<b>3 months (%)</b>	-5.83	-5.88	0.05	-5.90
<b>1 year (%)</b>	-5.40	-5.55	0.15	-5.67
<b>2 years (%)</b>	-3.45	-3.70	0.25	-3.73
<b>3 years (% pa)</b>	-0.04	-0.32	0.28	-0.33
<b>5 years (% pa)</b>	2.13	1.86	0.27	1.84

### Past performance is not a reliable indicator of future performance.

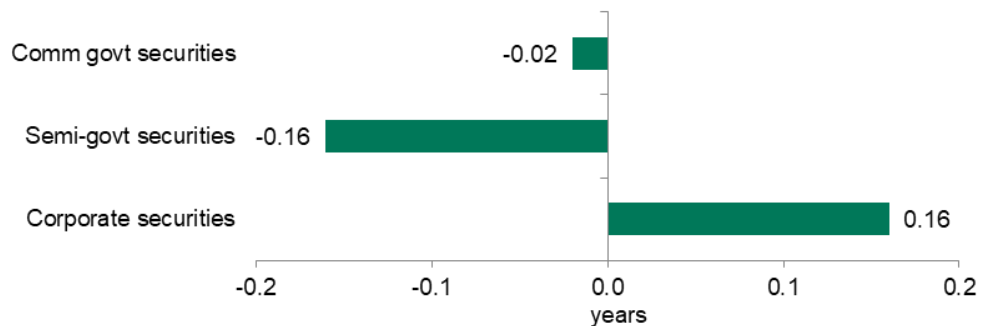
Total returns are calculated based on changes in net asset values and assumes the reinvestment of distributions. The Fund is benchmarked against the Bloomberg AusBond Composite 0+.

\*Total net returns are quoted after the deduction of all fees and expenses. Due to individual circumstances, your net returns may differ from the net returns quoted above.

## Key contributors to quarterly performance



## Relative duration positioning vs. Index



# Macquarie Master Enhanced Fixed Interest Fund

Quarterly report – 31 March 2022

---

## Fund highlights

The Portfolio outperformed the benchmark this quarter, driven by security selection.

### Security selection

The Portfolio's security selection was actively managed as the overweight to ultra-long Australian Commonwealth Government Bonds was unwound following the flattening, with the tapering of quantitative easing (QE), together with the lack of 20 year syndication from the Australian Office of Financial Management (AOFM), contributing to the outperformance in recent months.

Within semi-government securities, we have trimmed some of the short-maturity exposures where semi-government spreads are particularly rich, and added in the 10 year maturity segment where yield curves are already steep as markets anticipate in more issuance supply. The Portfolio has also taken micro relative value opportunities in semi-government securities during the quarter given the flattening of the basket.

The Portfolio has been positioned overweight derivatives versus physical securities both in swap and futures. We expect derivatives should also outperform physical securities now that the RBA has finished their asset purchasing program, with supply from the AOFM also likely to increase next financial year.

The Portfolio's credit security selection performed broadly in line with the benchmark. Higher-beta corporate bonds and subordinated financial paper have widened more aggressively in the selloff, as continued rate volatility and the Ukrainian invasion sparked a global risk-off move. Residential mortgage-backed security (RMBS) spreads also moved wider in Q1 as new deals in the primary market continued to print wider than secondary levels, while short-dated credit was impacted by new issuance. The Portfolio continued to benefit from the higher-than-benchmark carry over the quarter.

### Sector rotation

The Portfolio's sector positioning was actively traded. We began the quarter underweight to the semi-government sector but have reduced the size of this over the quarter by taking advantage of opportunities in primary. When QE ended the RBA needed to be replaced by another buyer and the balance sheets are the most likely contender given increased requirements for high quality liquid assets as the Committed Liquidity Facility ends. However, they are not obligated to buy at any price and can instead keep cash in exchange settlement balances, so we believe parts of the semi-government yield curve at negative asset swap spread are unattractive. We continue to hold swaps in the Portfolio as a hedge for the underweight to semi-government bonds given the historical correlation between these security types.

The Portfolio's credit positioning performed broadly in line with the benchmark despite the widening in investment grade credit spreads over the quarter.

## Market overview

The New Year started with optimism: there was genuine belief that the worst of the pandemic was behind; that combined fiscal and monetary support had restored economic growth to the pre-pandemic trend; that the supply shock would gradually dissipate through the year ahead; and, while inflation was a concern it was expected move lower in the months and quarters ahead. This all changed when Russia invaded Ukraine. Geopolitical uncertainty spiked, and a second supply shock was unleashed on the global economy with the previous optimistic outlook replaced by massive uncertainty.

During the quarter, commodity prices surged. Oil (+33%) and natural gas (US +51%, EU +86%) grabbed the headlines but there was broad strength across hard commodities. But the shock was even broader with many soft commodities surging (wheat +30%, soybeans +25%) due to the significance of both Russia and Ukraine in the global food supply chain. Inflation rates have already risen, and the highs are still likely months away. Central banks have pivoted hawkish, rate hikes have been delivered and the US Federal Reserve (Fed) reset expectations by signalling the possibility of rates hikes in 0.5% increments.

Interest rate markets repriced significantly, and this was the driver of performance in the quarter. Credit and emerging markets spreads did widen, but the rally into quarter end made the overall spread widening modest in the context of the repricing of bond yields. A key point of debate was the global flattening of yield curves, where the US 2-year 10-year Treasury yield spread retraced back from inversion and ended the quarter flat. A sustained inversion of this yield curve has historically been a reliable signal of recessionary risk in the next 12-18 months. The implication is that markets are signalling 'fragility' and therefore further volatility should be expected in the quarters ahead.

### Australian bond market

Renewed optimism with which we started 2022 came to a head over the quarter as the globe faced the Russia-Ukraine conflict with volatility erupting. Sharply rising inflation, together with a tenuous growth outlook and a global conflict that sent commodity prices soaring, led to an aggressive sell-off in bonds and spreads widening. Central banks repositioned themselves to fight inflation and, one by one like dominos, they replaced their patience with the need to fight inflation at all costs. The hawkish tone of central banks saw rates markets repriced for a steeper path, and after admitting that inflation may be more durable than previously anticipated generated discussion of actively selling down the balance sheet to drain liquidity out of the system. The politics of inflation was played out around the world as the US and Australia sought to reduce their deficits whilst Europe sought to expand. Markets expect the US yield curve to invert (negative spread between short- and longer-dated bonds) and this has been a reliable long-term indicator of recession.

The underperformance of the Australian rates market amidst poor liquidity conditions saw the Australia-US spread trading out to 50bps, and the front-end of the Australian yield curve moved to sit materially above the front-end of the US curve. The Australian 3 year yield sold off from 0.91% to 2.37% and the Australian 10 year yield sold off from 1.67% to 2.84%, whilst the slope of the curve flattened from 76bps to 25bps. The Reserve Bank of Australia (RBA) ceased their quantitative easing program in Australia and this, combined with the flight to quality, poor liquidity, and flows out of Asia into Japanese year-end, saw Australia underperform on a cross-market basis. The Australian Government Budget (AGB) announced that issuance will increase to \$125bn this year, a significant net step up relative to last year given the end of the RBA's Bond Buying Program. The Australian Office of Financial Management (AOFM) steadily issued \$25.2bn worth of bonds

## Macquarie Master Enhanced Fixed Interest Fund

Quarterly report – 31 March 2022

---

over the quarter across the entire yield curve, with the bulk going to either the 3 year-5 year sector or the 10 year bonds. The States also continued to chip away at their funding tasks as semi-government spreads to Australian Commonwealth Government Bonds' (ACGBs) tightened slowly.

### Global credit market

Volatility increased during Q1 as central banks started to reduce support and geopolitical tensions increased after Russia invaded Ukraine. Rates markets were the biggest mover over the quarter, putting additional pressure on risk assets, which finished the quarter weaker although rebounded from the lows during March.

US credit spreads widened over the quarter but did see some retracement in spreads in March as higher total yields attracted buyers and provided support. Results from the US earnings season for the December quarter remained supportive but with notably fewer upgrades to guidance. Cost pressures are an ongoing theme with management teams generally confident in the ability to pass on prices (with consumer demand so far resilient), but some industrial earnings misses were driven by the lack of available raw materials.

After a hawkish European Central Bank started the weakness in European risk assets, European credit had its worst month in February since March 2020 following Russia's invasion of Ukraine. Volatility maintained during March, though spreads retraced later in the month as higher yields saw some buyers emerge.

### Australian credit market

Australian credit underperformed over the quarter as domestic technical factors added to the influence of global events. This was driven by pressure on the higher quality end of Australian credit, with bank balance sheets having less demand for traditional alternative liquid assets like senior bank paper and senior residential mortgage-backed security tranches. These both repriced in the quarter and put pressure on the broader credit complex.

### Outlook

We had already modified our outlook for 2022 to reflect the impact from the war in Ukraine, to one where short-term inflation would remain more elevated than we previously expected, and at the same time we assessed that the medium term risks to growth have increased. That said, the aggressive signalling from the US Federal Reserve (Fed) was a surprise but not in the context of increased pressures on inflation in recent weeks. The challenge now is for the Fed to drive inflation back towards target without inflicting too much damage on growth. From our perspective, tighter monetary policy will in time slow aggregate demand. Current high inflation, however, is largely being driven by supply problems. This is a classic tool and target mismatch, which implies that the task in front of the Fed is difficult and, for markets, suggests that further volatility should be expected as the Fed navigates this path.

Rate markets globally have repriced sharply. The overhang of negative yields is quickly evaporating, evidenced by 2-year German yields moving into positive territory for the first time since 2014. None of this makes bonds an obvious buy, particularly as the Fed and other central banks are in aggressive hiking mode, but for investors, yields are indeed starting to look attractive outright and as a hedge against risk assets.

While inflation is now a problem, for risk assets the path of growth through 2022 should prove critical. This second supply shock has increased the risk of recession in the 12-18 months ahead. How central banks navigate the delivery of tighter monetary policy likely holds the key to whether recession becomes a reality, or we experience a 'soft landing' for the economy. Our investment approach has been cautious, and our outlook implies that fixed income markets will experience further volatility in the months ahead but one where value is beginning to re-emerge.

## Macquarie Master Enhanced Fixed Interest Fund

Quarterly report – 31 March 2022

---

**For more information speak to your financial adviser, call us on 1800 814 523, email [mim.clientservice@macquarie.com](mailto:mim.clientservice@macquarie.com) or visit [macquarieim.com](http://macquarieim.com)**

### Important information

Macquarie Investment Management Australia Limited ABN 55 092 552 611 AFS Licence 238321 is the issuer of units in, and responsible entity of the Fund. Macquarie Investment Management Global Limited ABN 90 086 159 060 AFSL 237843 is the investment manager of the Fund.

The above information is not personal advice and does not take into account the investment objectives, financial situation or needs of any person. Please review the Target Market Determination for the Fund available at [macquarieim.com/TMD](http://macquarieim.com/TMD) and consider if the Fund may be suitable for you. Investors should consider the offer document relating to the Fund in deciding whether to acquire or continue to hold units in the Fund. The offer document is available by contacting us on 1800 814 523. Past performance is not a reliable indicator of future performance. Future results are impossible to predict. This report includes opinions, estimates and other forward-looking statements which are, by their very nature, subject to various risks and uncertainties. Actual events or results may differ materially, positively or negatively, from those reflected or contemplated in such forward-looking statements. Forward-looking statements constitute the investment manager's judgement as at the date of preparation of this report and are subject to change without notice.

In preparing this document, reliance may have been placed, without independent verification, on the accuracy and completeness of information available from external sources. To the maximum extent permitted by law, no member of the Macquarie Group nor its directors, employees or agents accept any liability for any loss arising from the use of this document, its contents or otherwise arising in connection with it.

Other than Macquarie Bank Limited ABN 46 008 583 542 ("Macquarie Bank"), any Macquarie Group entity noted in this material is not an authorised deposit-taking institution for the purposes of the Banking Act 1959 (Commonwealth of Australia). The obligations of these other Macquarie Group entities do not represent deposits or other liabilities of Macquarie Bank. Macquarie Bank does not guarantee or otherwise provide assurance in respect of the obligations of these other Macquarie Group entities. In addition, if this document relates to an investment, (a) the investor is subject to investment risk including possible delays in repayment and loss of income and principal invested and (b) none of Macquarie Bank or any other Macquarie Group entity guarantees any particular rate of return on or the performance of the investment, nor do they guarantee repayment of capital in respect of the investment.

Bloomberg Finance L.P. and its affiliates (collectively, "Bloomberg") are not affiliated with Macquarie and do not approve, endorse, review, or recommend the Portfolio. Bloomberg and the Bloomberg AusBond Index or Indices referred to in this document are trademarks or service marks of Bloomberg and have been licensed to Macquarie. Bloomberg does not guarantee the timeliness, accurateness, or completeness of any data or information relating to the Bloomberg AusBond Index or Indices referred to in this document.